

Message Text

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TO SECSTATE WASHDC 8905
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USMISSION OECD PARIS
USMISSION EC BRUSSELS
USDEL MTN GENEVA

UNCLAS SECTION 01 OF 02 LONDON 20472

DEPARTMENT PASS TREASURY AND FEDERAL RESERVE BOARD

E.O. 11652: N/A
TAGS: ECON, UK
SUBJECT: HIGHLIGHTS OF THE BANK OF ENGLAND DECEMBER
QUARTERLY REPORT

SUMMARY: THE BANK OF ENGLAND QUARTERLY BULLETIN ATTRIBUTES STERLING'S SHARP DECLINE TO DOUBLE DIGIT INFLATION, RISING PUBLIC SECTOR BORROWING AND A CONTINUING BALANCE OF PAYMENTS DEFICIT. WARNING THAT PROSPERITY CANNOT BE REBUILT OVERNIGHT, THE BANK STRESSES THE URGENCY OF RESTORING BALANCE OF PAYMENTS EQUILIBRIUM. IT URGES THAT DOMESTIC DEMAND BE RESTRAINED SO AS TO LIMIT IMPORTS AND SUGGESTS A TWO-YEAR PERIOD OF FURTHER WAGE RESTRAINT TO PERMIT A LOWER LEVEL OF IMPORTS AND THE NECESSARY READJUSTMENTS FROM THE RIGIDITIES OF THE CURRENT INCOMES POLICY. THE BANK EXPECTS SLOW ECONOMIC GROWTH IN 1977
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COUPLED WITH RISING UNEMPLOYMENT, FALLING REAL INCOMES AND A SUBSTANTIAL IMPROVEMENT IN THE CURRENT ACCOUNT. END SUMMARY.

1. CURRENT ACCOUNT
THE BANK EXPECTS A RISE OF 8 TO 10 PERCENT IN THE

VOLUME OF OECD EXPORTS IN 1977. WITH THE DEPRECIATION OF STERLING IN EXCESS OF 20 PERCENT IN 1976, THE COST COMPETITIVENESS OF UK INDUSTRY HAS BEEN IMPROVED. HOWEVER, THE BANK POINTS TO A NEW PATTERN. UK EXPORTERS HAVE TAKEN GREATER PROFITS BY INCREASING THEIR STERLING PRICES AS THE POUND DECLINED THUS KEEPING THE TERMS OF TRADE FAIRLY STEADY. NEVERTHELESS THE BANK EXPECTS AN INCREASING PROPORTION OF BRITAIN'S ECONOMIC RESOURCES TO FLOW INTO THE EXTERNAL SECTOR. THE CURRENT ACCOUNT SHOULD IMPROVE WITH WEAK DOMESTIC DEMAND AND SUBSTANTIAL QUANTITIES OF NORTH SEA OIL RESTRAINING IMPORTS AND THE HOPED FOR EXPANSION OF OTHER INDUSTRIAL COUNTRIES TOGETHER WITH IMPROVED PROFITABILITY ENCOURAGING EXPORTS.

2. OUTPUT AND DEMAND

THE MAIN STIMULUS TO OUTPUT IS EXPECTED TO COME FROM NET EXPORTS WITH SOME CONTRIBUTION TO GROWTH ALSO COMING FROM INVENTORY ACCUMULATION. CONSUMER EXPENDITURE SHOULD DECLINE THROUGHOUT THE YEAR WHILE GOVERNMENT SPENDING WILL REMAIN ESSENTIALLY FLAT. MANUFACTURING INVESTMENT WILL RISE, PROBABLY BY LESS THAN THE 15-20 PERCENT INDICATED IN SURVEY LIKE HOUSING AND PUBLIC SECTOR INVESTMENT WILL BE WEAK. THE BANK THEREFORE CONCLUDES THAT 1977 WILL BE A YEAR OF SLOW EXPANSION OF OUTPUT.

3. COSTS AND PRICES

THE RISE IN PRICES IN 1976 HAS BEEN MODERATED BY SLOWER GROWTH IN LABOR COSTS AND A CYCLICAL UPTURN IN PRODUCTIVITY. HOWEVER THE BANK SINGLES OUT IMPORT COSTS AS HAVING BEEN RESPONSIBLE FOR 27 PERCENT OF THE INFLATION

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WHICH OCCURRED DURING THE FIRST HALF OF 1976. THIS IS OVER THREE TIMES THE CORRESPONDING FIGURE FOR ALL OF 1975. ON THE OTHER HAND, RISING LABOR COSTS ACCOUNTED FOR TWO-THIRDS OF THE INFLATION IN 1975. THIS FIGURE DROPPED TO TWO-FIFTHS IN THE FIRST HALF OF 1976. WITH REGARD TO 1977 THE BANK BELIEVES THAT THE PRESENT INCOMES POLICY COULD HOLD THE RISE IN AVERAGE EARNINGS TO 7-8 PERCENT IN THE 12 MONTHS THROUGH JULY 1977

(COMPANY SPENDING AND FINANCE

PROFITS NET OF DEPRECIATION AND INVENTORY APPREARED TO INCREASE BY 21.1 PERCENT DURING THE SECOND QUARTER OF 1976. DURING THE SAME PERIOD THE SHARE OF NET PROFITS IN NET DOMESTIC INCOME INCREASED FROM 4.7 TO 5.4 PERCENT. HOWEVER THIS IMPROVEMENT MUST BE

SEEN IN LIGHT OF THE 12.9 PERCENT PROFITS IN DO-

MESTIC INCOME IN 1965 AND THE 10 PERCENT SHARE IN 1972.
LOW LEVELS OF INVESTMENT CONTINUING RUNDOWNS OF IN-
VENTORIES HAVE IMPROVED CORPORATE CASH FLOW WHILE FIXED
INVESTMENT IN PRIVATE INDUSTRY INCREASED BOTH IN THE SEC-
OND AND THIRD QUARTERS, RISING FROM A BASE (1976 - 1)

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LOWER THAN ANY TIME SINCE 1968. IN RECENT MONTHS EQUITY
FLOTATIONS HAVE VIRTUALLY DRIED UP AFTER 5 STRAIGHT QUAR-
TERS DURING WHICH MORE THAN 1.6 BILLION POUNDS HAD BEEN
RAISED BY CORPORATIONS.

5. PERSONAL INCOMES AND SAVINGS.

THE ONE-SHOT INCOME TAX REBATE IN AUGUST CONTRIBUTED
TO A 3.5 PERCENT INCREASE IN PERSONAL INCOMES DURING THE
THIRD QUARTER. WITH PRICES RISING BY 2.3 PERCENT REAL
DISPOSABLE INCOME ROSE BY NEARLY 2 PERCENT. HOWEVER,
WITH AVERAGE EARNINGS LIKELY TO INCREASE BY 7-8 PERCENT
AND PRICES TO RISE BY 14-15 PERCENT, REAL INCOMES WILL

FALL FOR SOME TIME TO COME. THE BANK EXPECTS A SMALLER DECLINE IN SPENDING AS CONSUMERS REDUCE THEIR SAVINGS RATIOS. IN DESCRIBING THE PRESSURE ON REAL INCOMES IN BRITAIN, THE BANK POINTS OUT THAT REAL PERSONAL DISPOSAB-

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LE INCOME ROSE BY 15.5 PERCENT BETWEEN 1970 AND THE FIRST HALF OF 1976. HOWEVER, REAL NATIONAL DISPOSABLE INCOME (GDP ADJUSTED FOR THE CHANGE IN THE TERMS OF TRADE) ROSE BY 5.9 PERCENT OVER THE SAME PERIOD. THE BANK POINTS OUT THAT THIS DISPARITY WAS REFLECTED IN A SUBSTANTIAL FALL IN THE REAL INCOMES OF THE CORPORATE SECTOR AND THE PUBLIC SECTOR. IN THE FORMER, PROFITABILITY DECLINED OVER TIME WHILE IN THE LATTER REVENUES GREW MORE SLOWLY AND TRANSFER PAYMENTS ROSE SHARPLY TO THE PERSONAL SECTOR.

6. MONETARY DEVELOPMENTS.

DOMESTIC CREDIT EXPANSION INCREASED BY 1.955 BILLION POUNDS DURING THE THIRD QUARTER, A RISE OF 370 MILLION POUNDS. GOVERNMENT SALES OF GILTS DECLINED TO 605 MILLION POUNDS FROM A SECOND QUARTER FIGURE OF 1105 MILLION. A RISE OF 650 MILLION POUNDS IN BANK LENDING TO THE PRIVATE SECTOR LED TO THE IMPOSITION OF CREDIT RESTRICTIONS. THE CORSET, IN NOVEMBER.

7. EURO-CURRENCY MARKETS

THE LONDON EURO-CURRENCY MARKET GREW MORE SLOWLY IN THE THIRD QUARTER WITH TOTAL LIABILITIES RISING TO \$188 BILLION FROM THE SECOND QUARTER FIGURE OF \$186.4 BILLION. THE LARGEST LENDERS WERE THE OIL EXPORTING COUNTRIES, THE U.S., WESTERN EUROPEAN COUNTRIES OUTSIDE THE EC AND CANADA. JAPAN, OFFSHORE BANKING CENTERS, THE EC AND "OTHER COUNTRIES" WERE THE PRINCIPAL BORROWERS.

8. OIL MONEY MOVEMENTS

TOTAL OIL REVENUES OF EXPORTING COUNTRIES ROSE 1.4 BILLION DOLLARS TO 29.0 BILLION IN THE THIRD QUARTER. HOWEVER, THESE COUNTRIES' CASH SURPLUS AVAILABLE FOR INVESTMENT ABROAD, FOR GOVERNMENT LOANS OR ADDITIONS TO RESERVES IS ESTIMATED TO HAVE DECLINED BY 0.5 BILLION TO 8.3 BILLION DOLLARS. ABOUT HALF OF THIS FIGURE WENT INTO FINANCIAL RESERVES. OFFICIAL STERLING BALANCES HELD BY

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OIL EXPORTING COUNTRIES FELL BY 0.7 BILLION DOLLARS COMPARED WITH A SECOND QUARTER DROP OF 1.2 BILLION. INVEST-

MENTS IN U.S. TOTALLED 2.6 BILLION DOLLARS AFTER 4.3 BILLION IN THE SECOND QUARTER.

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